

ORIGINAL



MEMORANDUM

30

TO: Docket Control

FROM: Ernest G. Johnson  
*for* Director  
Utilities Division

DATE: May 27, 2005

RE: STAFF REPORT FOR CORONADO UTILITIES, INC., APPLICATION FOR A CERTIFICATE OF CONVENIENCE AND NECESSITY TO PROVIDE WASTEWATER SERVICE TO A PORTION OF PINAL COUNTY AND FOR AUTHORITY TO ISSUE SHORT AND LONG-TERM DEBT (DOCKET NO. SW-04305A-05-0086 AND SW-04305A-05-0087)

Attached is the Staff Report for Coronado Utilities, Inc., application for a Certificate of Convenience and Necessity ("CC&N") in Pinal County and for authority to issue short and long-term debt. Staff recommends the Commission approve the application for a CC&N and financing with conditions.

EGJ:JEF:red

Originator: Jim Fisher

Arizona Corporation Commission  
**DOCKETED**

MAY 27 2005

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**STAFF REPORT  
UTILITIES DIVISION  
ARIZONA CORPORATION COMMISSION**

**CORONADO UTILITIES, INC.**

**DOCKET NOS. SW-04305A-05-0086**

**AND**

**SW-04305A-05-0087**

**APPLICATION FOR A  
CERTIFICATE OF CONVENIENCE  
AND NECESSITY**

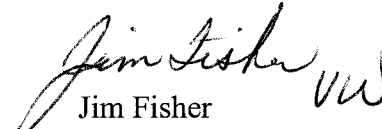
**AND**


**APPLICATION FOR AUTHORITY  
TO ISSUE SHORT AND LONG-TERM  
DEBT FOR ACQUISITION AND  
IMPROVEMENT OF WASTEWATER FACILITIES**


**MAY 2005**

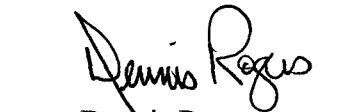
## STAFF ACKNOWLEDGMENT

The Staff Report for Coronado Utilities, Inc., (Docket Nos. SW-04305A-05-0086 and SW-04305A-05-0087) was the responsibility of the Staff members signed below. Jim Fisher was responsible for the review and analysis of the Company's application. Lyndon Hammon was responsible for the engineering and technical analysis. Crystal Brown was responsible for the review and recommendation on rate base and usage rates. Dennis Rogers was responsible for review and recommendation on the finance authorization.

  
Jim Fisher  
Executive Consultant

  
Lyndon Hammon  
Utilities Engineer

  
Crystal Brown  
Public Utilities Analyst V

  
Dennis Rogers  
Public Utilities Analyst IV

**EXECUTIVE SUMMARY  
CORONADO UTILITIES, INC.  
APPLICATION FOR A CC&N  
DOCKET NOS. SW-04305A-05-0086 AND SW-04305A-05-0087**

On February 10, 2005, Coronado Utilities, Inc., ("Coronado" or "Company") filed an Application for a Certificate of Convenience and Necessity ("CC&N") with the Arizona Corporation Commission ("ACC" or "Commission") to provide wastewater services to a portion of Pinal County and to issue short and long-term debt to finance the project.

Coronado is an Arizona corporation formed August 18, 2004, in good standing with the Commission's Corporation Division. The Company was formed for the purpose of ownership and operation of a wastewater utility serving the community of San Manuel, in Pinal County.

The community of San Manuel has received wastewater services from BHP Copper, Inc., ("BHP") for more than 50 years. BHP announced it was closing the mining operations and sought bidders to acquire and operate the existing collection and treatment facilities. Coronado entered into a purchase agreement with BHP to acquire the wastewater assets and its associated 84 acres of property.

In conjunction with the application for a CC&N, Coronado is also seeking approval to issue debt and encumber utility assets. Coronado intends to obtain authority for a capital structure of 10 percent equity and 90 percent debt. Coronado intends to obtain tax-exempt financing to acquire and upgrade the facilities. The financing will require Coronado to provide the lender with a lien on the utility facilities.

There is a continuing need for wastewater treatment in San Manuel. BHP is no longer willing to provide the service and has contracted with Coronado to ensure the assets are transferred to a Commission regulated utility operating with Arizona Department of Environmental Quality approval.

**Staff Recommendations**

Staff recommends that the Commission approve Coronado Utilities, Inc's., application for a Certificate of Convenience and Necessity to provide wastewater services, subject to the following conditions:

1. That the Commission authorize Coronado Utilities, Inc., the wastewater rates and charges shown on Schedule CB-WW-2.
2. That the Commission make a fair value rate base finding of \$3,096,163.
3. That Coronado utilize the depreciation rates stated in the attached Engineering Memorandum.

4. That Coronado be ordered to file a rate application in its fourth year of operations, using the third year as the test year.
5. That Coronado be authorized to obtain \$2,163,991 of long-term debt financing on the terms and conditions consistent with or better than those used in Staff's pro forma analysis subject to establishment of rates that provide Staff's recommended operating income.
6. That the Commission approve the granting of liens in favor of the lender as required to secure the borrowings authorized.
7. That the Commission deny Coronado's request to use loan funds for operating expenses or income.
8. That Coronado be authorized to engage in any transaction and to execute any documents necessary to effectuate the authorizations granted.
9. That Coronado be ordered to file copies of all executed financing documents with Docket Control within 90 days of loan closing.
10. That the Commission require Coronado Utilities, Inc., to file with Docket Control a copy of the Pinal County franchise within 365 days of the effective date of the decision in this matter.
11. That the Commission require Coronado Utilities, Inc., to file with Docket Control a copy of the Arizona Department of Environmental Quality Unified Water Quality Permit for the San Manuel Wastewater Treatment Facility authorizing a treatment and disposal capacity of 350,000 gallons per day within 365 days of the effective date of the decision and order in this matter.
12. That the Commission require Coronado Utilities, Inc., to file with Docket Control a tariff consistent with the rates and charges authorized by the Commission within 30 days of the effective date of a decision in this matter.
13. That the Commission require Coronado Utilities, Inc., to maintain its books and records in accordance with the NARUC Uniform System of Accounts for Water Utilities.
14. That the Commission require Coronado Utilities, Inc., to notify the Compliance Section of the Utilities Division within 15 days of initiating service to customers in the proposed service area.
15. That the Commission authorize Coronado Utilities, Inc., to use the depreciation rates as recommended by Staff.

Staff further recommends that the Commission's Decision granting this Certificate of Convenience and Necessity to Coronado Utilities, Inc., be considered null and void without

further order from the Commission should Coronado fail to meet Conditions 10, 11 and 12 within the time specified.

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## **Introduction**

On February 10, 2005, Coronado Utilities, Inc., ("Coronado" or "Company") filed an Application for a Certificate of Convenience and Necessity ("CC&N") with the Arizona Corporation Commission ("ACC" or "Commission") to provide wastewater services to a portion of Pinal County.

On February 23, 2005 the Commission's Utilities Division Staff ("Staff") informed Coronado the applications were sufficient for administrative purposes.

## **Background**

Coronado is an Arizona corporation formed August 18, 2004, in good standing with the Commission's Corporation Division. The Company was formed for the purpose of ownership and operation of a wastewater utility serving the community of San Manuel, in Pinal County.

The community of San Manuel has received wastewater services from BHP Copper, Inc., ("BHP") for more than 50 years. BHP announced it was closing the mining operations and sought bidders to acquire and operate the existing collection and treatment facilities. Pivotal, through Coronado, entered into a purchase agreement with BHP to acquire the wastewater assets and its associated 84 acres of property. Pivotal entered into a separate agreement with BHP to guaranty Coronado's obligations under the acquisition agreement.

Coronado intends to obtain a CC&N, take over the existing operations and begin construction of required improvements. In conjunction with the application for a CC&N, Coronado has also sought approval of an initial financing authorization. Coronado intends to obtain authority for a capital structure of 10 percent equity and 90 percent debt. Coronado intends to obtain tax-exempt financing to acquire and upgrade the facilities. The financing will require Coronado to provide the lender with a lien on the utility facilities.

Pivotal has operated and managed other Arizona utilities including: Pine Meadows Utilities, LLC., Sweetwater Creek Utilities, Bensch Ranch Utilities, LLC, Cross Creek Ranch Water Company and Verde Santa Fe Wastewater Company.

Coronado's initial Board of Directors is listed as Mr. Clingman, Mr. Williamson and Mr. Zemp. Mr. Clingman is employed by the Santec Corporation, a manufacturer of wastewater treatment plants. Mr. Zemp is a vice-president of Santec Corporation and a certified operator in Arizona and Colorado. Mr. Williamson is the managing member of Pivotal Utility Management, LLC, ("Pivotal") of Denver Colorado.

According to the application, Coronado will purchase the assets by way of a cash payment of \$75,001 agreement to construct effluent delivery lines to the nearby golf course and abiding by the terms of the agreement.

### **Pivotal Utilities and Affiliates**

Pivotal owns three (3) and operates five (5) utilities in Arizona. Pivotal currently operates Pine Meadows Utilities, LLC., Sweetwater Creek Utilities, Bensch Ranch Utilities, LLC, Cross Creek Ranch Water Company and Verde Santa Fe Wastewater Company. Pivotal owns Pine Meadows Utilities, LLC., Bensch Ranch Utilities, LLC, and Verde Santa Fe Wastewater Company.

Pivotal's affiliate, Pine Meadows Utilities, LLC., ("Pine Meadows") obtained its initial CC&N in Commission Decision No. 64599 (March 4, 2002). According to Pine Meadow's most recent available Annual Report to the Commission, 2003, the utility reports \$775,358 in total assets, \$21,360 of revenue and an annual loss of \$10,826 for operations.

Pivotal operates Sweetwater Creek Utilities, Inc., ("Sweetwater"). The utility obtained its initial CC&N in Commission Decision No. 59916 (December 10, 1996). According to Sweetwater's most recent available Annual Report to the Commission, 2003, the utility reports \$603,634 in total assets, \$222,182 of revenue and an annual income of \$31,061.

A second Pivotal affiliate, Bensch Ranch Utilities, LLC, ("Bensch Ranch") obtained its initial CC&N in Commission Decision No. 67180 (August 10, 2004). Bensch Ranch has not filed an Annual Report with the Commission.

Pivotal also operates Cross Creek Ranch Water Company, ("Cross Creek") which obtained its initial CC&N in Commission Decision No. 65978 (June 17, 2003). According to Cross Creek's most recent available Annual Report to the Commission, 2003, the utility reports that it has not constructed any assets and is not serving customers yet.

A third Pivotal affiliate, Verde Santa Fe Wastewater Company, Inc., ("Verde Santa Fe") obtained its initial CC&N in Commission Decision No. 60779 (April 8, 1998). According to Verde Santa Fe's most recent available Annual Report to the Commission, 2003, the utility reports \$668,311 in total assets, \$99,578 of revenue and an annual loss of \$3,641.

The Utilities Division Compliance Section reports no outstanding issues with any of the Pivotal affiliates at this time. The respective Annual Reports for the operational utilities show all property taxes to be paid.

### **Coronado's Agreement with BHP**

On November 1, 2004, BHP and Coronado entered into a purchase agreement for wastewater collection and treatment facilities serving approximately 1,600 customers in the community San Manuel. The purchase price was set at \$325,000, payable through an agreed upon "Improvement Credit" of \$249,999 to the purchase price and additional consideration of \$75,001.

The "Improvement Credit" is defined as Coronado's agreement to design, permit and construct Golf Course Improvements related to a reclaimed water pipeline to transfer effluent to the golf course and transfer ponds. The completion of these facilities will result in Coronado receiving an Improvement Credit of \$249,999 towards the full purchase price.

According to the agreement at Section 4.(d), Coronado is to pay BHP \$75,001 after wastewater treatment plant improvements have been made and prior to August 10, 2006.

Section 5(e) requires Coronado to negotiate a form of Codes, Covenants and Restrictions, ("CC&R's") to be recorded against the property. The CC&R's will require Coronado to construct pipelines and supply reclaimed water to the golf course. Coronado further agrees to price the reclaimed water at no more the power costs required to pump the water to the golf course.

According to Section 5(j), Pivotal furnished an irrevocable letter of credit to BHP in the amount of \$200,000 to cover performance of all terms, conditions and provisions by Pivotal and Coronado.

The agreement, at Section 7, requires Coronado to obtain a CC&N from the Commission for operation of wastewater facilities in the town of San Manuel. Coronado is also required to obtain the associated Aquifer Protection Permit ("APP") from the Arizona Department of Environmental Quality, ("ADEQ"), applicable to the wastewater treatment plant and the associated upgrades. In the event Coronado fails to obtain the required permits, BHP has the option to extend the time frame or terminate the agreement.

Section 9(e) provides BHP with a release from Coronado for any right of action under law, including environmental liabilities, which Coronado may have in the future arising from the presence of contamination, hazardous materials or physical condition of the property.

Section 10(e) provides that BHP will decommission and clean-up the existing wastewater plant if Coronado constructs a new plant and provides BHP with written notice the existing facilities are no longer needed.

The agreement provides at Section 16(c) that BHP will provide water to Coronado until January 1, 2006, at which time the Company will need to secure supplies from Arizona Water Company.

Section 16(e) provides that Coronado is responsible for cleaning the oxidation and evaporation ponds, as well as discarding the waste materials taken from the ponds. BHP agrees to assist in the first cleaning of the ponds by transporting to an appropriate landfill all waste materials removed.

### **The Proposed Financing**

The Company proposes a twenty-year fully amortizing loan for an amount not to exceed \$3,300,000 from the Municipal Leasing Credit Corporation ("MLCC") with an annual interest rate between 6 and 7 percent and a projected monthly debt service of \$24,266. MLCC will arrange financing in conjunction with the Pinal County Industrial Development Authority. According to the application, "Financing will likely occur in three phases: 1) construction financing, to commence at the time all permits are obtained by Coronado and purchase of the existing wastewater treatment plant and related system is complete; 2) interim financing, if a short-term bridge loan is needed to cover the time when construction begins but before all permits have been obtained; and 3) the issuance of a permanent loan after the completion of all system improvements and a new wastewater treatment plant."<sup>1</sup>

### **Financial Analysis**

Schedule DRR-1, attached, presents selected pro forma financial information from the Company's application reflecting projected year one results of operations. Schedule DRR-1 reflects the Company's proposed twenty-year \$3,139,623 loan at 6.96 percent and an initial investment of \$292,363 in common equity and pro forma first year operating income of \$174,665. The resulting proposed highly leveraged capital structure is composed of 6.14 percent short-term debt, 80.91 percent long-term debt, and 12.95 percent equity.

The proposed capital structure is more highly leveraged than is appropriate for an established utility. A new utility should have more equity in its capital structure than an established utility. Accordingly, Staff concludes that the Company's proposed debt is excessive. Staff recommends that the Company not issue debt exceeding 60 percent of its initial total capital. The projected times interest earned ratio ("TIER") and debt service coverage ratio ("DSC") resulting from the Company's proposal are 0.32 and 0.24, respectively, showing that cash flow is insufficient to cover debt obligations.

TIER represents the number of times earnings cover interest expense on long-term debt. A TIER greater than 1.0 means that operating income is greater than interest expense. A TIER less than 1.0 is not sustainable in the long term but does not mean that debt obligations cannot be met in the short term.

DSC represents the number of times internally generated cash will cover required principal and interest payment on long-term debt. A DSC greater than 1.0 indicates that operating cash flow is sufficient to cover debt obligations. A DSC less than 1.0 means that debt service obligations cannot be met by cash generated from operations and that another source of funds is needed to avoid default.

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<sup>1</sup> Id. Page 5, lines 1 thru 6.

Schedule DRR-2, Column A shows the Company's pro forma capital structure at the end of year three. Column B shows Staff's recommended pro forma capital structure consisting of 60 percent debt from a \$2,163,991 loan and 40.0 percent common equity of \$1,442,660. Column B also shows the projected TIER and DSC from Staff's recommended rates as 2.43 and 2.56, respectively.

Staff concludes that the initial capital structure resulting from Coronado's proposal for the issuance of the \$3,139,623 loan is not compatible with the public interest or consistent with sound financial practices.

Staff further concludes that use of loan proceeds for operating expenses or income is an inappropriate use of the funds.

However, Staff concludes that issuance of debt in the amount of \$2,163,991 which represents 60 percent of the Company's total capital and Common Equity of \$1,442,660 which represents 40 percent of the Company's total capital is within Coronado's corporate powers, compatible with the public interest, consistent with sound financial practices and will not impair its ability to perform service.

#### **Projected Fair Value Rate Base ("FVRB")**

The Company provided information that was sufficient to calculate the projected original cost rate base ("OCRB") as shown on Schedule CSB-WW2. Staff evaluated the projected OCRB as the fair value rate base. Staff recommends a fair value rate base equal to the end of year three projection of \$3,096,163.

#### **Projected Plant in Service**

In the first year, the Company plans to invest \$150,000 for organizational costs and \$75,000 in land for a total investment of \$225,000. In the second and third years, the Company plans to invest \$3,066,000 and \$66,000, respectively, in backbone plant and on-site facilities resulting in a projected Plant in Service of \$3,357,000 by the end of year three as shown on Schedule CSB-WW2. Staff accepted and made no adjustments to the Company's projected year three plant in service balance. Staff's adjustment to reduce Plant in Service by \$132,000 reflects Staff's use of the year three projected plant balance versus the Company's use of the year five balance.

#### **Rate Design**

Schedule CSB-WW4 presents a complete list of the Company's proposed, and Staff's recommended rates and charges. The Company provided a cost of service study based upon estimated sewer flows. Staff adjusted (i.e., increased by 20 percent) the flow volumes for commercial customers and schools to reflect that these customer classes have wastewater from large kitchens and other sources that is generally more expensive to treat. Staff used the adjusted

cost of service study as a guide to allocate revenues to the various customer classes. The Company's proposed and Staff's recommended rate designs consist of a monthly customer charge and a volumetric charge.

#### Monthly Customer Charges

The Company proposes a monthly customer charge (flat rate) of \$42.00 for residential customers. The rate is based upon the amount of revenue allocated to the residential customer class divided by the number of residential customers. The Company proposes a \$5.00 monthly customer charge for each mobile home park resident, \$65.00 for each commercial customer, and no monthly customer charge for schools.

Staff proposes a \$7.50 monthly customer charge for each customer class. The \$7.50 is the Company's estimate of management and billing costs per month per customer.<sup>2</sup>

#### Volumetric Charge

The Company proposes a \$0.42 per 100 gallons of water usage volumetric charge for commercial customers and schools.<sup>3</sup> Staff recommends \$0.4901, \$0.9205, and \$0.2648 per 100 gallons of water usage for the Mobile Home Park, Commercial, and Schools customer classes, respectively. Staff's recommended volumetric rate design (Plan A) is contingent upon the Company obtaining a formal written agreement with Arizona Water Company to obtain monthly water usage data for Commercial customers, Mobile Home Park customers and Schools for as long as Coronado has a rate design based upon monthly water usage. If Coronado is unable to obtain the agreement, Staff recommends the Plan B - Alternative Rate Design that is based upon the capacity multipliers of various water meter sizes as shown on Schedule CSB-WW4.

#### Effluent Sales

The Company proposes to sell effluent at \$0.15 per 1,000. Staff reviewed the rate and found it to be reasonable.<sup>4</sup>

#### Service Charges

Staff decreased the Establishment (After Regular Working Hours), and Service Call Out (After Regular Working Hours) to reflect charges currently recommended by Staff for similar utilities. The Company did not provide any cost justification to support its proposed charges.

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<sup>2</sup> Per response to data request CSB 2-11.

<sup>3</sup> Coronado was unable to obtain monthly water usage data for residential customers from Arizona Water Company.

<sup>4</sup> The existing wastewater system does not sell effluent. Effluent sales are expected once a golf course is constructed. The date the golf course will be built is uncertain.

### Service Charges

Staff decreased the Establishment (After Regular Working Hours), and Service Call Out (After Regular Working Hours) to reflect charges currently recommended by Staff for similar utilities. The Company did not provide any cost justification to support its proposed charges.

### **Staff Recommendations**

Staff recommends approval of the Staff proposed Plan A, or if necessary Plan B, rates and charges as shown in Schedule CSB-WW4. Staff further recommends that the implementation of Staff's Plan A rate design be contingent upon the Company obtaining a formal written agreement with AWC to obtain monthly water usage data for Commercial customers, Mobile Home Park customers and Schools for as long as Coronado has a rate design based upon monthly water usage. If the Company is unable to obtain the agreement, Staff recommends implementation of the Plan B rate design.

### **Section 208 Plan Approval**

The Federal Water Pollution Control Act as amended by the Water Quality Act of 1987 ("Clean Water Act") is a commitment by the federal government to the elimination of pollution in the nation's waters. Each state is required, under Section 208 of the Clean Water Act, to develop and implement area-wide water quality management plans for pollution control.

In Arizona, six (6) Councils of Government, ("COGs") have been designated by the Governor as "Water Quality Management Planning Agencies" under Section 208, of the Clean Water Act. Mohave County ("The County") is designated by the Governor and the EPA as the area wide water quality management planning agency for Mohave County.

The guidelines for 208 planning set forth in the Clean Water Act are fairly broad so that the various water quality issues in different areas of the nation can be addressed appropriately. Each 208 Plan must identify the water quality management needs in its planning area and provide a program to develop solutions. The County 208 planning process is an ongoing effort in response to changing water resource issues, regulations, treatment technologies and changing demographics.

On the federal level, the Environmental Protection Agency ("EPA") has the responsibility of overseeing the planning efforts necessary to meet the specific requirements of Section 208. ADEQ administers both the basin-wide planning and water quality monitoring programs. In addition, ADEQ is responsible for reviewing and enforcing water quality standards for the State. For the County 208 Program, the EPA and ADEQ provides guidance in the terms of policy, procedure and review of documents to assure adherence to the requirements of the Clean Water Act.

A major effort of the 208 Plan is the Point Source Plan. Point Source Planning is primarily directed at compiling the preferred wastewater collection and treatment system for the affected area through the year 2020. Toward that end, the Point Source Plan examines population and wastewater flow projections, wastewater treatment plant siting, treatment methods, effluent disposal, reclaimed water reuse and sludge management.

### **ADEQ Permits**

The objective of a Point Source Plan is to identify the preferred wastewater collection and treatment and effluent reuse or disposal systems for the affected area. The regulatory framework for management of water quality is comprised of permit compliance and monitoring of protected uses. The ADEQ defines, monitors and enforces water quality standards for protected uses of surface waters, aquifers and public water supplies. The ADEQ permit framework for point source management consists of three primary elements consisting of the Arizona Pollutant Discharge Elimination System ("AZPDES") the Aquifer Protection Permit ("APP") and the reclaimed water reuse permit program.

The purpose of the AZPDES permit programs is to regulate the quality of point source discharges into the waters of the nation. Based on specific criteria, discharges to rivers, tributaries to the rivers, dry washes and various lakes and canals within the affected area are subject to the AZPDES permit program provisions.

The ADEQ has established Surface Water Quality Standards ("SWQS") as required to meet the goals of the federal Clean Water Act and to protect the quality of surface waters in the state. The EPA incorporates the SWQS and federal regulation related to surface water quality and effluent discharge quality into the AZPDES permits. Pollutant levels established by the AZPDES permit programs vary among wastewater reclamation facilities depending upon the designated use of reclaimed water. Permits are typically issued for a term of five years.

### **Aquifer Protection Permit**

The APP was established by the Environmental Quality Act of 1986 and implemented by rule in 1989. The purpose of the APP program is to protect the groundwater quality and public health from potential environmental risks posed by the facilities that discharge pollutants to the land surface, underlying soil, or groundwater that have a potential to reach an aquifer.

The APP permitting requirements are determined based on the type of facility or land use, capacity of the facility, and/or the type of discharges that the facility will produce. The most crucial requirements for obtaining an APP are demonstrating that the Best Available Demonstrated Control Technology ("BADCT") will be used to minimize the discharge of pollutants, Aquifer Water Quality Standards will not be violated and that the facility possesses the financial and technical capability to comply with the permit conditions.



The Environmental Quality Act requires that all domestic wastewater and disposal facilities requiring an APP use BADCT as part of their wastewater treatment process. The ADEQ adopted BADCT requirements for new sewage treatment facilities. The design review of sewage treatment facilities has been consolidated into the APP application review process. BADCT requirements are defined within the rules which require secondary treatment, removal for new facilities and expansion of existing facilities. The revision of the APP rule took effect January 2001.

The reclaimed water use permit program, established in 1985, allows the reuse of reclaimed water for a variety of applications such as agriculture, urban lakes, golf course irrigation, ponds and industrial uses. Water reclamation plants are required by rules to have a reuse permit for the release of reclaimed water for reuse purposes.

There are two main categories of reclaimed water reuse including direct non-potable reuse and indirect reuse. Direct reuse consists of irrigation and makeup water for urban lakes. Indirect reuse typically involves aquifer recharge and recovery. The indirect reuse of reclaimed water usually involves recharge to an aquifer for storage and future recovery. The reclaimed water is typically allowed to infiltrate through the dry soils above the aquifer allowing additional treatment. Recharge projects using reclaimed water are required to obtain an APP.

Coronado has applied to ADEQ for an APP. The application is proceeding through ADEQ's review and authorization process.

On January 3, 2005, ADEQ informed Pivotal that in consultation with CAAG, the replacement wastewater treatment facility proposed for San Manuel will not require a Plan 208 amendment. ADEQ also informed Pivotal that if the plant were to require a discharge permit, increased service area, or increased treatment capacity, a Plan 208 amendment would be required.

## **Technical Analysis**

### **A. Design**

The existing wastewater treatment facility consists of two aerobic stabilization ponds, effluent evaporation ponds, a sludge digester, and sludge drying beds, which treated mining and domestic wastewater. This treatment facility is over fifty years old and at the end of its usefulness. The facility uses an obsolete treatment process and is oversized if influent is limited to domestic wastewater from the community of San Manuel. Most importantly the current San Manuel wastewater treatment facilities cannot meet ADEQ requirements for best available demonstrated control technology ("BADCT") for permitting purposes. Consequently the system should be replaced and the old facility abandoned and closed.

Coronado will construct a new wastewater treatment plant (herein also "WWTP"). The new WWTP will be a Santec® 0.350 million gallon per day ("MGD") activated sludge plant,

which incorporates de-nitrification in the secondary treatment process. The entire facility will include, grit and solids removal, influent flow metering, flow equalization basins, sludge treatment and handling, disinfection, standby power, and ancillary laboratory and control buildings. The existing evaporation ponds will be retained for effluent disposal.

Current domestic wastewater flows are 0.281 MGD annual average day and 0.304 MGD as average day, peak month, which are well within the capacity of the proposed treatment facility. If flows increase in the future, the Santec plant is readily expandable by adding modular process units.

On March 2, 2005, Coronado submitted an Aquifer Protection Application to DEQ for construction of the new WWTP. Coronado anticipates the commencement of operation by June 30, 2006.

B. Effluent Disposal

The wastewater treatment plant will produce an effluent of a quality sufficient to meet the standards for open access irrigation. Therefore, effluent disposal will be via golf course irrigation and evaporation/percolation in the existing evaporation ponds. Staff estimated that there is at least 16 days storage in the evaporation ponds (assuming 3 feet depth). The golf course demands 0.400 MGD, and the ponds can evaporate and additional 0.085 MGD. There will also be additional effluent disposal capacity by percolation, but this rate is as yet undefined.

According to Staff's analysis, the total disposal capacity of 0.485 MGD should be sufficient to accommodate the design flow of 0.350 MGD. Consumptive rates, winter balances, and storage requirements will all be refined in the ADEQ Unified Water Quality Permit (Aquifer Protection Permit and the Permit for Direct Reuse of Reclaimed Water).

According to the terms of the purchase agreement, Coronado will be required to construct a treated effluent line to the golf course. However, Coronado will receive a credit in the amount of the effluent line cost, against the purchase price of the wastewater treatment facility.

C. Costs

An Engineer's Opinion of Cost was prepared for the new San Manual Wastewater Treatment Plant. They are summarized below:

WASTEWATER TREATMENT PLANT

	<u>Cost</u>
Headwords	\$71,276
Pumping Systems	\$158,236
Process Tanks	\$1,046,290

Aeration System	\$80,024	
Disinfection	\$83,000	
Install and Construct	\$500,000	
WWTP Sub Total	\$1,938,826	or 5.54 \$/gallon

#### SITE AND ANCILLIARY EQUIPMENT

Operation & Lab Building	\$240,000
Stand-by Power	\$98,000
SCADA <sup>5</sup> & Lab equipment	\$35,000
Storage pond rehab	\$100,000
Effluent force main	\$250,000

SITE & FACILITY SUB-TOTAL	\$2,661,826
---------------------------	-------------

CONTINGENCIES	\$338,174	(≈12.5%)
---------------	-----------	----------

FACILITY TOTAL	\$3,000,000
----------------	-------------

PURCHASE PRICE FOR OLD WWTP & COLLECTION SYSTEM	\$325,000
--	-----------

CREDIT FOR EFFLUENT LINE	-\$250,000
--------------------------	------------

GRAND TOTAL	\$3,075,000
-------------	-------------

Debt authorization	\$3,300,000
--------------------	-------------

The above estimated costs appear to be within historic magnitudes and reasonable expectations. However, approval of this CC&N and financing application does not imply any particular future treatment for the rate base. No "used and useful" determination of the proposed plant in service was made, and no conclusions should be inferred for rate making or rate base purposes

#### Environmental Assessment

One of the potential pitfalls of this acquisition is the possibility that the utility or its ratepayers could face future claims as a result of past disposal practices by the mine at the wastewater treatment site. This includes, but is not limited to, any future or potential damages, clean-up costs, closure costs, or remediation costs as a result of past disposal practices pursuant

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<sup>5</sup> SCADA is an acronym for Supervisory Control And Data Acquisition. SCADA is the software which sits on top of the hardware and manages and controls the processes.

to the Resource Conservation and Recovery Act, the Toxic Substances Control Act, or any other applicable state and federal environmental law.

In the Purchase Agreement between BHP and Coronado, Coronado is indemnified by BHP for any present or future contamination that can be associated to the mining activities which took place in the past, or that may be discovered in the future. In addition, a phase one and phase two environmental assessment was conducted on the land being sold to Coronado, and no hazardous contamination was found that would preclude the use of the site for a WWTP facility.

### Depreciation Rates

Staff has developed typical and customary depreciation rates within a range of anticipated equipment life. These rates are presented in Table 2, and it is recommended that the Company use the depreciation rates by individual NARUC category, as delineated in this table.

#### DEPRECIATION RATES FOR WASTEWATER SYSTEM

Acct. No.	Depreciable Plant	Average Service Life (Years)	Annual Accrual Rate (%)
354	Structures & Improvements	30	3.33
355	Power Generation Equipment	30	3.33
360	Collection Sewers – Force	50	2.00
361	Collection Sewers – Gravity	50	2.00
362	Special Collecting Structures	50	2.00
363	Services to Customers	50	2.00
364	Flow Measuring Devices	10	10.00
365	Flow measuring Installations	20	5.00
366	Reuse Service	50	2.00
367	Reuse Meters and Meter Installations	30	3.33
370	Receiving Wells	30	3.33
371	Pumping Equipment	10	10.00
374	Reuse Distribution Reservoirs	40	2.50
375	Reuse Transmission and Distribution System	50	2.00
380	Treatment and Disposal Equipment	20	5.00
381	Plant Sewers	20	5.00
382	Outfall Sewer Lines	25	4.00
389	Other Plant & Misc Equipment	15	6.67
390	Office Furniture & Equipment	15	6.67
390.1	Computers & Software	5	20.00

391	Transportation Equipment	5	20.00
392	Store Equipment	25	4.00
393	Tools, Shop & Garage Equipment	20	5.00
394	Laboratory Equipment	10	10.00
395	Power Operated Equipment	20	5.00
396	Communication Equipment	10	10.00
397	Miscellaneous Equipment	10	10.00
398	Other Tangible Plant	----	----

### **County Franchise**

Coronado has not obtained a county franchise for water or wastewater service.

### **Staff Recommendations**

Staff recommends that the Commission approve Coronado Utilities, Inc., application for a Certificate of Convenience and Necessity to provide wastewater services, subject to the following conditions:


1. That the Commission authorize Coronado Utilities, Inc., the wastewater rates and charges shown on Schedule CB-WW-2.
2. That the Commission make a fair value rate base finding of \$3,096,163.
3. That Coronado utilize the depreciation rates stated in the attached Engineering Memorandum.
4. That Coronado be ordered to file a rate application in its fourth year of operations, using the third year as the test year.
5. That Coronado be authorized to obtain \$2,163,991 of long-term debt financing on the terms and conditions consistent with or better than those used in Staff's pro forma analysis subject to establishment of rates that provide Staff's recommended operating income.
6. That the Commission approve the granting of liens in favor of the lender as required to secure the borrowings authorized.
7. That the Commission deny Coronado's request to use loan funds for operating expenses or income.
8. That Coronado be authorized to engage in any transaction and to execute any documents necessary to effectuate the authorizations granted.


9. That Coronado be ordered to file copies of all executed financing documents with Docket Control within 90 days of loan closing.
10. That the Commission require Coronado Utilities, Inc., to file with Docket Control a copy of the Pinal County franchise within 365 days of the effective date of the decision in this matter.
11. That the Commission require Coronado Utilities, Inc., to file with Docket Control a copy of the Arizona Department of Environmental Quality Unified Water Quality Permit for the San Manuel Wastewater Treatment Facility authorizing a treatment and disposal capacity of 350,000 gallons per day within 365 days of the effective date of the decision and order in this matter.
12. That the Commission require Coronado Utilities, Inc., to file with Docket Control a tariff consistent with the rates and charges authorized by the Commission within 30 days of the effective date of a decision in this matter.
13. That the Commission require Coronado Utilities, Inc., to maintain its books and records in accordance with the NARUC Uniform System of Accounts for Water Utilities.
14. That the Commission require Coronado Utilities, Inc., to notify the Compliance Section of the Utilities Division within 15 days of initiating service to customers in the proposed service area.
15. That the Commission authorize Coronado Utilities, Inc., to use the depreciation rates as recommended by Staff.

Staff further recommends that the Commission's Decision granting this Certificate of Convenience and Necessity to Coronado Utilities, Inc., be considered null and void without further order from the Commission should the Coronado fail to meet Conditions 10, 11 and 12 within the time specified.

## **MEMORANDUM**

TO: Jim Fisher  
Executive Consultant II  
Utilities Division

FROM: Barb Wells   
Information Technology Specialist  
Utilities Division

THRU: Del Smith   
Engineering Supervisor  
Utilities Division

DATE: March 14, 2005

RE: **CORONADO UTILITIES, INC. (DOCKET NO. SW-04305A-05-0086)**  
**REVISED LEGAL DESCRIPTION**

The area requested by Coronado for a wastewater CC#N has been plotted using a revised legal description, which has been docketed. This legal description is attached and should be used in place of the original description submitted with the application.

Also attached are copies of the maps for your files.

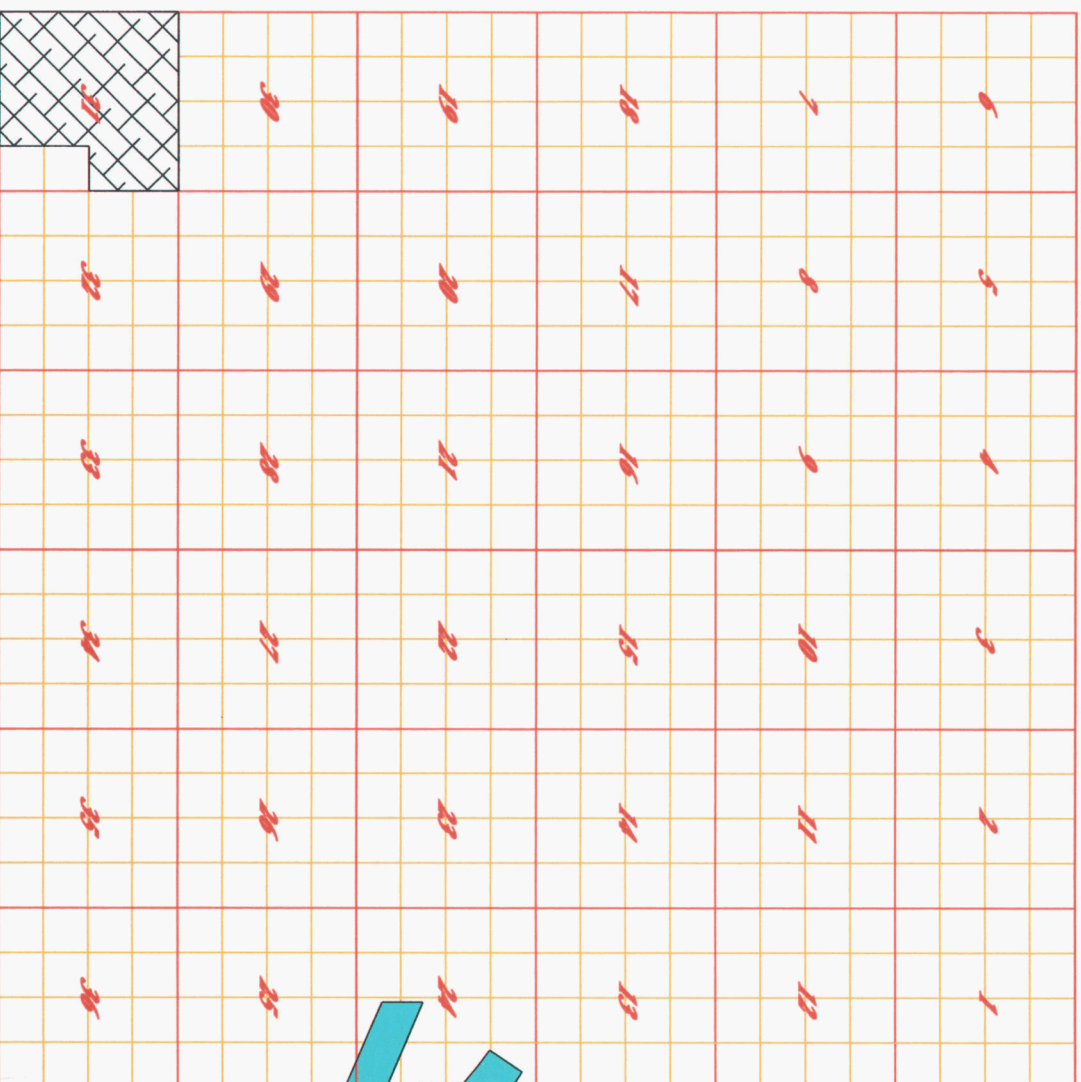
:bsw

### Attachments

cc: Docket Control  
Mr. Jay Shapiro  
Mr. Jason Williamson  
Deb Person (Hand Carried)  
File

# COUNTY: Pinal

## RANGE 16 East



W-1445 (34)(5)

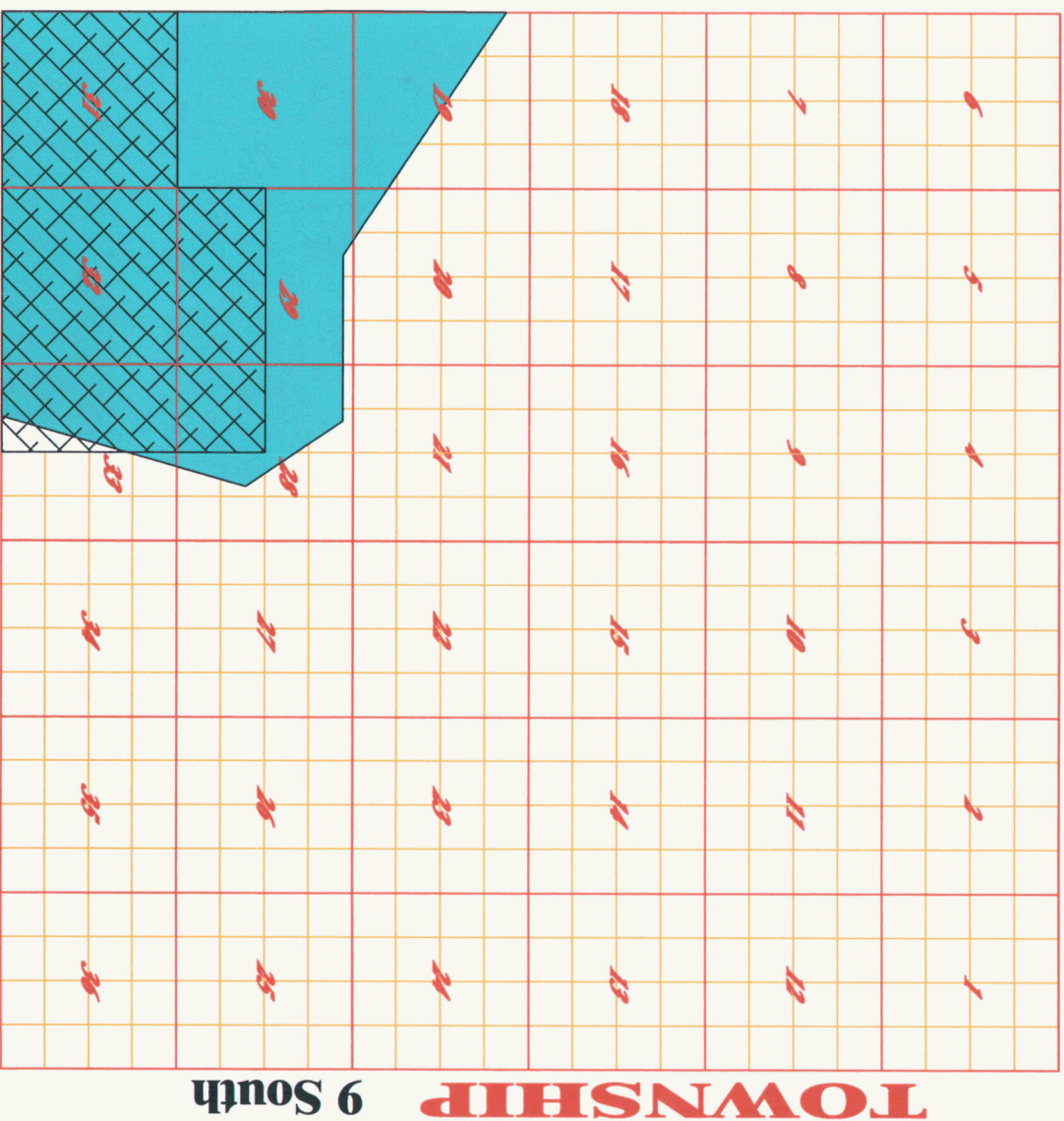
Arizona Water Company (Oracle)



Coronado Utilities, Inc.  
SW-4305-05-086  
Application for CC&N for Sewer



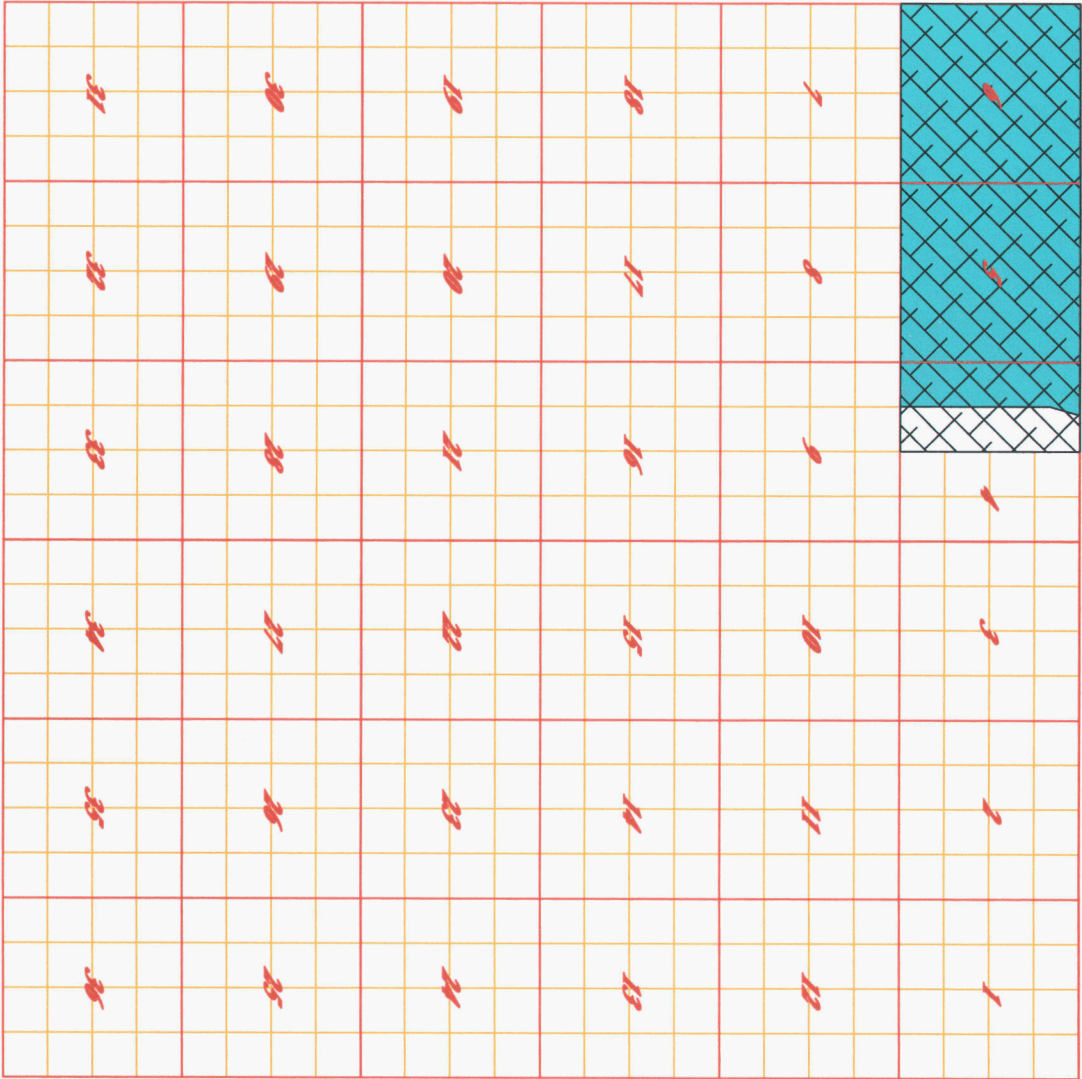
# RANGE 17 East



**Coronado Utilities, Inc.**  
**SW-4305-05-086**  
**Application for CC&N for Sewer**

COUNTY: Pinal

RANGE 17 East



TOWNSHIP

10 South

W-1445 (34)(3)

Arizona Water Company (San Manuel)



Coronado Utilities, Inc.  
SW-4305-05-086  
Application for CC&N for Sewer

## **Legal Description of The San Manuel Sewer District**

That part of Section 24 and 25, Township 9 South, Range 16 East, and Sections 19,20,28,29,30,31,32 and 33, Township 9 South, Range 17 East, and Sections 4,5 and 6, Township 10 South, Range 17 East, of the Gila and Salt River Base and Meridian, Pinal County, Arizona, described as follows;

Commencing at the southeast corner of the above mentioned Section 5, Township 10 South, Range 17 East, said point being the point of beginning of the land to be described, (The basis of bearing is the south line of the southeast quarter of Section 5, Township 10 South, Range 17 East being north 89 degrees 57 minutes 50 seconds West).

THENCE North 89 degrees 57 minutes 50 seconds West for a distance of 2650.23 feet along the south line of said Section 5 to the south quarter corner being a found GLO brass cap dated 1924.

THENCE North 89 degrees 56 minutes 30 seconds West for a distance of 2645.27 feet along the south line of said Section 5 to the southwest corner being a found GLO brass cap dated 1924.

THENCE South 89 degrees 40 minutes 58 seconds West for a distance of 2638.79 feet along the south line of said Section 6 to the south quarter corner being a found GLO brass cap dated 1924

THENCE South 89 degrees 37 minutes 16 seconds West for a distance of 2632.37 feet along the south line of said Section 6 to a found GLO stone.

THENCE North 00 degrees 05 minutes 24 seconds West for a distance of 5538.15 feet along the west line of said Section 6 to a found brass cap, being the intersection of Township 9 and 10 South, and Range 16 and 17 East.

THENCE North 00 degrees 54 minutes 22 seconds West for a distance of 5291.81 feet along the west line of said Section 31 to the northwest corner being a found 5/8 inch rebar.

THENCE North 00 degrees 56 minutes 15 seconds West for a distance of 2662.69 feet along the west line of said Section 30 to the west quarter corner being a found 3/4 inch open pipe.

THENCE North 00 degrees 59 minutes 01 seconds West for a distance of 2322.17 feet along the west line of said Section 30 to a found aluminum cap LS 4154 on the south line of the San Manuel Golf Course.

THENCE North 66 degrees 21 minutes 49 seconds West for a distance of 801.59 feet along the south line of the San Manuel Golf Course to a found aluminum cap LS 4154.

THENCE North 66 degrees 22 minutes 41 seconds West for a distance of 1887.00 feet along the south line of the San Manuel Golf Course to a found Aluminum cap LS 4154.

THENCE North 00 degrees 00 minutes 54 seconds East for a distance of 1201.47 feet along the west line of the San Manuel Golf Course to a found Aluminum cap LS 4154 on the south right-of-way line of highway 76.

THENCE South 67 degrees 01 minutes 57 seconds East for a distance of 1855.09 feet along the south right-of-way line of highway 76 to a ADOT monument  $\frac{3}{4}$  inch steel pin at station 119+00.

THENCE South 67 degrees 02 minutes 16 seconds East for a distance of 797.52 feet along the south right-of-way line of highway 76 to a found aluminum cap LS 4154 at station 111+03.30.

THENCE North 00 degrees 56 minutes 02 seconds West for a distance of 1658.80 feet along the west line of said Section 19 to the west quarter corner being a found  $\frac{3}{4}$  inch rebar.

THENCE North 00 degrees 56 minutes 39 seconds West for a distance of 556.81 feet along the west line of said Section 19 to a point on the south line of San Manuel Airport lease.

THENCE North 56 degrees 09 minutes 30 seconds West for a distance of 47.31 feet along the south line of San Manuel Airport lease to a set  $\frac{1}{2}$  inch rebar.

THENCE along a curve to the left having a radius of 11535.71 feet, and an arc length of 1216.19 feet subtended by a cord of North 52 degrees 00 minutes 23 seconds West for a distance of 1215.61 feet along the south line of the San Manuel airport lease to a set  $\frac{1}{2}$  inch rebar.

THENCE North 33 degrees 50 minutes 30 seconds East for a distance of 1156.98 feet to a point.

THENCE South 56 degrees 09 minutes 30 seconds East for a distance of 9318.47 feet to a point on the north fence line of the Commodity Warehouse.

THENCE North 90 degrees 00 minutes 00 seconds East for a distance of 4960.97 feet to a point.

THENCE South 33 degrees 57 minutes 38 seconds East for a distance of 3504.07 feet to a point on a fence corner.

THENCE South 15 degrees 52 minutes 36 seconds West for a distance of 8527.39 feet to a set  $\frac{1}{2}$  inch rebar on the west right-of-way line of Highway 76.

THENCE South 00 degrees 00 minutes 00 seconds East for a distance of 4680.74 feet to a point on the south line of said Section 4.

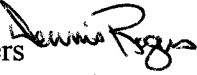
THENCE South 89 degrees 54 minutes 01 seconds West for a distance of 1173.24 feet along the south line of said Section 4, to the point of beginning of the land described.

Together with and subject to covenants, easements, and restrictions of record.

Said property contains 5104.38 acres more or less.

**EXHIBIT A  
MEMORANDUM**

TO: Crystal Brown  
Public Utilities Analyst V  
Financial and Regulatory Analysis Section, Utilities Division

FROM: Dennis Rogers   
Public Utilities Analyst IV  
Financial and Regulatory Analysis Section, Utilities Division

DATE: May 23, 2005

RE: CORONADO UTILITIES, INC.  
DOCKET NO. SW-04305A-05-0087

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**Introduction**

Coronado Utilities, Inc. ("Coronado" or "Company") filed a Financing Application<sup>1</sup> on February 10, 2005, with the Arizona Corporation Commission ("Commission") for authorization to issue a combination of short and long term debt instruments totaling not more than \$3,300,000, the proceeds of which are intended to finance the acquisition of wastewater infrastructure.

On February 10, 2005, Coronado filed with the Commission an Application<sup>2</sup> for a new Certificate of Convenience and Necessity ("CCN" or "Certificate") to provide wastewater utility service in a portion of Pinal County.

On February 11, 2005, Coronado filed a Motion to Consolidate the two applications.

March 16, 2005, a Procedural Order was issued by the Administrative Law Judge to consolidate the two filings.

**Notice**

Coronado published Notice in the San Manuel Miner, a weekly newspaper, on April 27, 2005, and provided Staff with a copy of the Notice and affidavit of the publisher. A copy of that published Notice is attached along with a copy of the notice the Company mailed to all customers receiving service.

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<sup>1</sup> Docket No. SW-04305A-05-0087

<sup>2</sup> Docket No. SW-04305A-05-0086

### **Background**

Coronado is an Arizona perpetual corporation which is an affiliate of Pivotal Utility Management, L.L.C. ("Pivotal"). Pivotal operates and manages several Arizona public utility service corporations. Pivotal has entered into a separate agreement with BHP Copper ("BHP") to guaranty the performance of Coronado's obligations under the purchase agreement. Additionally, Pivotal entered into an operation and maintenance agreement with BHP to operate and manage the current wastewater treatment facility during construction of a new wastewater treatment facility. Coronado is proposing to purchase approximately 84 acres of land together with the wastewater and related improvements, located in Pinal County near San Manuel, Arizona.

### **Purpose of Financing**

Coronado proposes to use the proceeds of its \$3,139,623 borrowing to purchase the BHP wastewater treatment system and related appurtenances located near San Manuel, Arizona. The application states, "In addition, the financing will be used to construct a new wastewater treatment facility to replace the current wastewater treatment facility, which is approximately fifty-two (52) years old and in need of upgrades to meet applicable governmental requirements, including the Arizona Department of Environmental Quality ("ADEQ") guidelines for best available design control technology."<sup>3</sup>

### **Description of Proposed Financing**

The Company proposes a twenty-year fully amortizing loan for an amount not to exceed \$3,300,000 from the Municipal Leasing Credit Corporation ("MLCC") with an annual interest rate between 6 and 7 percent and a projected monthly debt service of \$24,266. MLCC will arrange financing in conjunction with the Pinal County Industrial Development Authority. According to the application, "Financing will likely occur in three phases: 1) construction financing, to commence at the time all permits are obtained by Coronado and purchase of the existing wastewater treatment plant and related system is complete; 2) interim financing, if a short-term bridge loan is needed to cover the time when construction begins but before all permits have been obtained; and 3) the issuance of a permanent loan after the completion of all system improvements and a new wastewater treatment plant."<sup>4</sup>

### **Financial Analysis**

Schedule DRR-1, attached, presents selected pro forma financial information from the Company's application reflecting projected year one results of operations. Schedule DRR-1 reflects the Company's proposed twenty-year \$3,139,623 loan at 6.96 percent and an initial investment of \$292,363 in common equity and pro forma first year operating income of

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<sup>3</sup> Coronado's Utilities, Inc.'s Financing Application, Page 1, lines 21 thru 25.

<sup>4</sup> Id. Page 5, lines 1 thru 6.

\$174,665. The resulting proposed highly leveraged capital structure is composed of 6.14 percent short-term debt, 80.91 percent long-term debt, and 12.95 percent equity.

The proposed capital structure is more highly leveraged than is appropriate for an established utility. A new utility should have more equity in its capital structure than an established utility. Accordingly, Staff concludes that the Company's proposed debt is excessive. Staff recommends that the Company not issue debt exceeding 60 percent of its initial total capital. The projected times interest earned ratio ("TIER") and debt service coverage ratio ("DSC") resulting from the Company's proposal are 0.32 and 0.24, respectively, showing that cash flow is insufficient to cover debt obligations.

TIER represents the number of times earnings cover interest expense on long-term debt. A TIER greater than 1.0 means that operating income is greater than interest expense. A TIER less than 1.0 is not sustainable in the long term but does not mean that debt obligations cannot be met in the short term.

DSC represents the number of times internally generated cash will cover required principal and interest payment on long-term debt. A DSC greater than 1.0 indicates that operating cash flow is sufficient to cover debt obligations. A DSC less than 1.0 means that debt service obligations cannot be met by cash generated from operations and that another source of funds is needed to avoid default.

Schedule DRR-2, Column A shows the Company's pro forma capital structure at the end of year three. Column B shows Staff's recommended pro forma capital structure consisting of 60 percent debt from a \$2,163,991 loan and 40.0 percent common equity of \$1,442,660. Column B also shows the projected TIER and DSC from Staff's recommended rates as 2.43 and 2.56, respectively.

#### **Staff Conclusions and Recommendations**

Staff concludes that the initial capital structure resulting from Coronado's issuance of the proposed \$3,139,623 loan is not compatible with the public interest or consistent with sound financial practices.

Staff further concludes that use of loan proceeds for operating expenses or income is an inappropriate use of the funds.

Staff further concludes that issuance of debt in the amount of \$2,163,991 which represents 60 percent of the Company's total capital and Common Equity of \$1,442,660 which represents 40 percent of the Company's total capital is within Coronado's corporate powers, compatible with the public interest, consistent with sound financial practices and will not impair its ability to perform service.

Staff recommends authorization to obtain \$2,163,991 of long-term debt financing on the terms and conditions consistent with or better than those used in Staff's pro forma analysis subject to establishment of rates that provide Staff's recommended operating income.

Staff further recommends approval of granting of liens in favor of the lender as required to secure the borrowings authorized.

Staff further recommends denial of Coronado's request to use loan funds for operating expenses or income.

Staff further recommends authorizing Coronado to engage in any transaction and to execute any documents necessary to effectuate the authorizations granted.

Staff further recommends that Coronado be ordered to file copies of all executed financing documents with Docket Control within 90 days of loan closing.



**Coronado Utilities**

Docket Nos. SW-04305A-05-0086 &amp; SW-04305A-05-0087

CC&amp;N and Financing

Schedule DRR-1

**FINANCIAL ANALYSIS**

## Company Income Statement and Capital Structure at the End of Year One

	Company Application		
1	Operating Income	\$	174,665
2	Depreciation & Amort.		0
3	Income Tax Expense		103,601
4			
5	Interest Expense		221,447
6	Repayment of Principal		76,877
7			
8			
9	<b>TIER<sup>1</sup></b>		
10	[1+3] ÷ [5]		0.32
11	<b>DSC</b>		
12	[1+2+3] ÷ [5+6]		0.24
13			
14			
15			
16			
17			
18	Short-term Debt	\$221,447	6.14%
19			
20	Long-term Debt	\$2,918,176	80.91%
21			
22	Common Equity	\$467,028	12.95%
23			
24	Total Capital	\$3,606,651	100.00%
25			
26			
27	<sup>1</sup> EBIT Interest coverage (earnings before interest and taxes)		

**Coronado Utilities**

Docket Nos. SW-04305A-05-0086 &amp; SW-04305A-05-0087

CC&amp;N and Financing

Schedule DRR-2

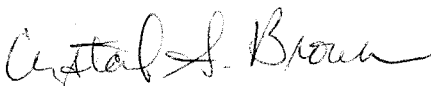
**FINANCIAL ANALYSIS**

Company Year Three Income Statement and Capital Structure as Filed  
 Staff Recommended Pro Forma Year Three Including Effects of the Staff Recommended Capital Structure

		[A] Company Application Year Three		[B] Staff Pro Forma Year Three	
1	Operating Income	\$	204,629	\$	277,912
2	Depreciation & Amort.		151,936		151,936
3	Income Tax Expense		103		84,320
4					
5	Interest Expense		210,000		148,985
6	Repayment of Principal		88,323		51,721
7					
8					
9	<b>TIER<sup>1</sup></b>				
10	[1+3] ÷ [5]		0.97		2.43
11	<b>DSC</b>				
12	[1+2+3] ÷ [5+6]		1.19		2.56
13					
14					
15					
16					
17					
18	Short-term Debt <sup>2</sup>	\$210,000	5.99%	\$148,985	4.13%
19					
20	Long-term Debt <sup>2</sup>	\$2,758,898	78.71%	\$2,015,006	55.87%
21					
22	Common Equity <sup>2</sup>	\$536,288	15.30%	\$1,442,660	40.00%
23					
24	Total Capital	\$3,505,186	100.00%	\$3,606,651	100.00%
25					
26					
27	<sup>1</sup> EBIT Interest coverage (earnings before interest and taxes)				
	<sup>2</sup> Column B reflects initial capitalization without results of operations for years one and two.				

## MEMORANDUM

TO: Jim Fisher  
Executive Consultant  
Utilities Division

FROM: Crystal Brown   
Public Utilities Analyst V  
Financial and Regulatory Analysis Section  
Utilities Division

DATE: May 24, 2005

RE: CORONADO UTILITIES, INC.  
DOCKET NO. SW-04305A-05-0086

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### Introduction

On February 10, 2005, Coronado Utilities, Inc. ("Coronado" or "Company"), filed an Application with the Arizona Corporation Commission ("Commission") for a Certificate of Convenience and Necessity ("CC&N") to provide wastewater service to the community of San Manuel located in Pinal County, Arizona.

San Manuel's waste water service is currently provided by BHP Copper, Inc. ("BHP"). BHP's wastewater system was constructed primarily to serve its mining operations. In June 1999, BHP announced that it would close its mining operations and, in connection therewith, discontinue wastewater service to the community of San Manuel. On November 10, 2004, BHP entered into a Purchase Agreement ("Agreement") with Coronado for the sale of a parcel of land that includes the wastewater treatment plant.

Historical operating and financial information exists but does not provide sufficient<sup>1</sup> information to establish rates for this wastewater system. In response to data request CSB 2-14, the Company reported that the expense data provided by BHP did not include administrative, overhead or depreciation and amortization expense. In addition, Staff determined from talking to the Company that BHP did not provide an amount for the cost of electricity needed for electric purchased pumping power as BHP did not segregate the cost from its mining operations.

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<sup>1</sup> BHP did not separate a significant amount of its wastewater financial data from its mining operations financial data. Therefore, the wastewater treatment cost data is incomplete. Additionally, historical costs are not representative of costs going forward because ADEQ requirements cause the need to build a new wastewater treatment facility.

The San Manuel community that Coronado proposes to serve has approximately 1,250 single family residences, 300 mobile home residences, 60 commercial establishments, and three schools. The current wastewater treatment facility is old and does not meet Arizona Department of Environmental Quality's ("ADEQ") standards. Coronado plans to retire the existing wastewater facility and construct a new facility that meets ADEQ requirements. Coronado expects to complete the new facility in the latter part its first year of operations. Staff expects Coronado's third year of operations to be the first full year of typical operating results with the new plant. Therefore, Staff recommends rates based on projections of the Company's third-year of operations, as adjusted by Staff. Staff is basing its recommendations on year three instead of year five as is the normal practice for CC&N applications because the Company has a stable, existing customer base and the new facilities are expected to be in operation for that entire year.

Staff recommends revenue that exceeds the Company's proposed revenue of \$959,576 by \$5,717. Staff's recommended revenue would generate operating income of \$277,912 resulting in an 8.98 percent rate of return on a Staff adjusted original cost rate base of \$3,096,163 as shown on Schedule CSB-WW1.

#### **Projected Fair Value Rate Base ("FVRB")**

The Company provided information that was sufficient to calculate the projected original cost rate base ("OCRB") as shown on Schedule CSB-WW2. Staff evaluated the projected OCRB as the fair value rate base. Staff recommends a fair value rate base equal to the end of year three projection of \$3,096,163.

#### **Projected Plant in Service**

In the first year, the Company plans to invest \$150,000 for organizational costs and \$75,000 in land for a total investment of \$225,000. In the second and third years, the Company plans to invest \$3,066,000 and \$66,000, respectively, in backbone plant and on-site facilities resulting in a projected Plant in Service of \$3,357,000 by the end of year three as shown on Schedule CSB-WW2. Staff accepted and made no adjustments to the Company projected year three plant in service balance. Staff's adjustment to reduce Plant in Service by \$132,000 reflects Staff's use of the year three projected plant balance versus the Company's use of the year five balance.

#### **Accumulated Depreciation**

In year three, the Company anticipates a \$227,573 Accumulated Depreciation balance as shown on Schedule CSB-WW2. Staff accepted and made no adjustments to the Company projected year three balance. Staff's adjustment to reduced Accumulated Depreciation by \$307,831 reflects Staff's use of the year three balance rather than the Company's use of the year five balance.

### Customer Deposits

The Company projects that the customer deposits balance will be \$33,264 in year three. Staff accepted and made no adjustments to the Company projected year three balance. Staff's adjustment to reduce customer deposits by \$3,024 reflects Staff's recommended use of the year three customer deposit balance rather than the year five balance used by the Company.

### **Projected Operating Income**

As noted previously, Staff concluded that the projections for year three of operations provide the preferred basis for setting rates because that is the year that the new facilities are expected to be operational for the entire year, and the Company has a stable, existing customer base.

### Projected Operating Revenues

Staff recommends year three operating revenues of \$965,293 as shown on Schedule CSB-WW3. Staff's recommended revenue recognizes Staff's adjustments to operating expenses and capital structure and provides an 8.98 percent rate of return on a Staff adjusted original cost rate base of \$3,096,163 as shown on Schedule CSB-WW1.

### Projected Operating Expenses

Staff's adjustments to reflect its projections for Operating Expenses in year three resulted in a net decrease of \$34,843, from \$722,224 to \$687,381 as shown on Schedule CSB-WW3.

#### *Outside Services*

Staff reviewed the Outside Services expense for the year three and found it to be reasonable. Staff decreased Outside Services expense by \$12,960 from \$140,760 to \$127,800 to reflect year three expenses rather than year five expenses.

#### *Income Tax Expense*

Staff increased Income Tax Expense by \$70,965, from \$13,355 to \$84,320 to reflect application of the statutory federal and state income tax rates to Staff taxable income.

#### *Property Tax Expense*

Staff decreased Property Tax Expense by \$3,903, from \$56,210 to \$52,307 to reflect year three expenses rather than year five expenses.

### *Depreciation Expense*

Staff reviewed the Depreciation Expense for year three and found it to be reasonable. Specifically, Staff reviewed the Company proposed depreciation rates and found them to be consistent, without exception, with those normally recommended by Staff. Staff decreased Depreciation Expense by \$2,640, from \$154,576 to 151,936 to reflect year three expenses rather than year five expenses.

### *Miscellaneous Expense - Bad Debt Expense*

The Company's bad debt expense is combined with other expenses in the Miscellaneous Expense Account. The Company proposes \$95,958 (or 10 percent of revenues) in year five for bad debt expense. Staff reduced the amount and percentage for two reasons.

First, the Company is proposing to collect customer deposits. Arizona Administrative Code ("AAC") R14-2-603 (B)(7)(a) allows utilities to require a deposit of up to two times the average residential class bill. Additionally, R14-2-603 (B)(5)(a) allows utilities to re-establish the deposit if the customer becomes delinquent in the payment of bills 3 or more times within 12 consecutive months. Further, R14-2-609 (C)(1)(b) allows utilities to terminate the service of a customer for nonpayment of a delinquent bill.

Secondly, the historical data regarding bad debt expense, in this case, is not indicative of the ongoing results because BHP did not follow up with notices or collections activity on delinquent accounts. Implementation of proper collection procedures should produce a reduction in uncollectible accounts.

### **Rate Design**

Schedule CSB-WW4 presents a complete list of the Company's proposed, and Staff's recommended rates and charges. The Company provided a cost of service study based upon estimated sewer flows. Staff adjusted (i.e., increased by 20 percent) the flow volumes for commercial customers and schools to reflect that these customer classes have wastewater from large kitchens and other sources that is generally more expensive to treat. Staff used the adjusted cost of service study as a guide to allocate revenues to the various customer classes. The Company's proposed and Staff's recommended rate designs consist of a monthly customer charge and a volumetric charge.

### **Monthly Customer Charges**

The Company proposes a monthly customer charge (flat rate) of \$42.00 for residential customers. The rate is based upon the amount of revenue allocated to the residential customer class divided by the number of residential customers. The Company proposes a \$5.00 monthly customer charge for each mobile home park resident, \$65.00 for each commercial customer, and no monthly customer charge for schools.

Staff proposes a \$7.50 monthly customer charge for each customer class. The \$7.50 is the Company's estimate of management and billing costs per month per customer.<sup>2</sup>

#### Volumetric Charge

The Company proposes a \$0.42 per 100 gallons of water usage volumetric charge for commercial customers and schools.<sup>3</sup> Staff recommends \$0.4901, \$0.9205, and \$0.2648 per 100 gallons of water usage for the Mobile Home Park, Commercial, and Schools customer classes, respectively. Staff's recommended volumetric rate design (Plan A) is contingent upon the Company obtaining a formal written agreement with Arizona Water Company to obtain monthly water usage data for Commercial customers, Mobile Home Park customers and Schools for as long as Coronado has a rate design based upon monthly water usage. If Coronado is unable to obtain the agreement, Staff recommends the Plan B - Alternative Rate Design that is based upon the capacity multipliers of various water meter sizes as shown on Schedule CSB-WW4.

#### Effluent Sales

The Company proposes to sell effluent at \$0.15 per 1,000. Staff reviewed the rate and found it to be reasonable.<sup>4</sup>

#### Service Charges

Staff decreased the Reconnection/Delinquent charge to reflect the typical charge currently recommended by Staff for similar utilities. The Company did not provide any cost justification to support its proposed charges.

#### Staff Recommendations

Staff recommends approval of the Staff proposed Plan A, or if necessary Plan B, rates and charges as shown in Schedule CSB-WW4. Staff further recommends that the implementation of Staff's Plan A rate design be contingent upon the Company obtaining a formal written agreement with AWC to obtain monthly water usage data for Commercial customers, Mobile Home Park customers and Schools for as long as Coronado has a rate design based upon monthly water usage. If the Company is unable to obtain the agreement, Staff recommends implementation of the Plan B rate design.

Staff further recommends that the Commission make a fair value rate base finding of \$3,096,163.

Staff further recommends that the Company be ordered to file for a rate application in its

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<sup>2</sup> Per response to data request CSB 2-11.

<sup>3</sup> Coronado was unable to obtain monthly water usage data for residential customers from Arizona Water Company.

<sup>4</sup> The existing wastewater system does not sell effluent. Effluent sales are expected once a golf course is constructed. The date the golf course will be built is uncertain.

fourth year of operations, using the third year as the test year.



**Coronado Utilities, Inc.**

Docket No. SW-04305A-05-0086

Test Year Ended: Third Year of Operation

Schedule CSB - WW1

**SUMMARY OF FILING**

-- Proposed Rates --		
	Company as Filed	Staff as Adjusted
Revenues:		
Revenues	\$939,648	\$965,293
Effluent Revenues	18,128	0
Establishment Charges	1,800	0
Total Operating Revenue	\$959,576	\$965,293
Operating Expenses:		
Operation and Maintenance	\$498,083	\$398,818
Depreciation	154,576	151,936
Property & Other Taxes	56,210	52,307
Income Tax	13,355	84,320
Total Operating Expense	\$722,224	\$687,381
Operating Income/(Loss)	\$237,352	\$277,912
Rate Base O.C.L.D.	\$2,917,308	\$3,096,163
Rate of Return - O.C.L.D.	8.14%	8.98%
Operating Margin	24.74%	28.79%

NOTE: Operating Margin represents the proportion of funds available to pay interest and other below the line or non-ratemaking expenses.

**Coronado Utilities, Inc.**

Docket No. SW-04305A-05-0086

Schedule CSB -WW2

Test Year Ended: Third Year of Operation

**PROJECTED  
ORIGINAL COST RATE BASE**

	Company Proposed Year 5	Staff Adjustments	Staff Recommended Year 3
Plant in Service	\$3,489,000	(\$132,000)	\$3,357,000
Less:			
Accum. Depreciation	535,404	(\$307,831)	227,573
<b>Net Plant</b>	<b>\$2,953,596</b>	<b>\$175,831</b>	<b>\$3,129,427</b>
Less:			
Advances in Aid of Construction	0	\$0	\$0
Advance Refunds	0	\$0	0
<b>Net Advances</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>
Contributions Gross	0	\$0	0
Less:			
Amortization of CIAC	0	\$0	0
<b>Net CIAC</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>
Less:			
Customer Deposits	\$36,288	(\$3,024)	\$33,264
<b>Total Deductions</b>	<b>\$36,288</b>	<b>\$0</b>	<b>\$33,264</b>
Plus:			
Cash Working Capital	\$0	\$0	\$0
Materials and Supplies Inventory	0	\$0	0
Prepayments	0	\$0	0
<b>Total Additions</b>	<b>\$0</b>	<b>\$0</b>	<b>\$0</b>
<b>Rate Base</b>	<b>\$2,917,308</b>	<b>\$175,831</b>	<b>\$3,096,163</b>

**PROJECTED STATEMENT  
OF OPERATING INCOME**

	Company Proposed Year 5	Staff Adjustments	Staff Recommended Year 3
Revenues:			
Residential	\$750,240	(\$6,634)	\$743,606
Commercial	\$57,600	\$33,182	\$90,782
Mobile Home Park	\$122,208	(\$5,893)	\$116,315
Schools	\$9,600	\$4,990	\$14,590
Effluent Sales	18,128	(\$18,128)	0
Other Revenue	1,800	(\$1,800)	0
<b>Total Operating Revenue</b>	<b>\$959,576</b>	<b>\$5,717</b>	<b>\$965,293</b>
Operating Expenses:			
Salaries and Wages	\$91,000	\$0	\$91,000
Sludge Removal Expense	0	\$0	0
Purchased Power, Pumping Equip	80,640	\$0	80,640
Sewage Treatment and Testing	0	\$0	0
Repairs and Maintenance	4,000	\$0	4,000
Office Supplies and Expense	0	\$0	0
Outside Services	140,760	(\$12,960)	127,800
Rents	0	\$0	0
Transportation Expenses	0	\$0	0
General Insurance	5,000	\$0	5,000
Depreciation Expense	154,576	(\$2,640)	151,936
Income Tax	13,355	\$70,965	84,320
Property Tax	56,210	(\$3,903)	52,307
Miscellaneous Expense	176,683	(\$86,305)	90,378
<b>Total Operating Expenses</b>	<b>\$722,224</b>	<b>(\$34,843)</b>	<b>\$687,381</b>

<b>OPERATING INCOME/(LOSS)</b>	<b>\$237,352</b>	<b>\$40,560</b>	<b>\$277,912</b>
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Other Income/(Expense):			
419 Interest and Dividend Income	\$6,867	(\$1,107)	\$5,760
421 Non-Utility Income	0	\$0	0
427 Interest Expense	196,850	(\$47,865)	148,985
4XX Reserve/Replacement Fund Deposit	0	\$0	0
426 Miscellaneous Non-Utility Expense	0	\$0	0
<b>Total Other Income/(Expense)</b>	<b>(\$189,983)</b>	<b>\$46,758</b>	<b>(\$143,225)</b>

<b>NET INCOME/(LOSS)</b>	<b>\$47,369</b>	<b>\$87,318</b>	<b>\$134,687</b>
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## RATE DESIGN

### PLAN A

#### Monthly Customer Charges

		-Proposed Rates-	
		Company	Staff
Residential		\$42.00	\$49.53
Commercial		65.00	\$7.50
Mobile Home Park		5.00	\$7.50
School		N/A	\$7.50

#### Volumetric Rates

Commercial - per 100 gallons of water usage	\$0.4200	\$1.1870
Mobile Home Park - per 100 gallons of water usage	0.4200	0.4813
School - per 100 gallons of water usage	0.4200	0.3180

#### Effluent Sales

Per 1,000 Gallons for General Irrigation	\$0.15	\$0.15
Per Acre Foot (or 325,851 gallons) for General Irrigation	N/A	\$48.88

### PLAN B - ALTERNATIVE RATE DESIGN<sup>1</sup>

#### Monthly Customer Charges - Based on Water Meter Size

		-Proposed Rates-	
		Company	Staff
5/8" x 3/4" Meter		N/A	\$49.57
3/4" Meter		N/A	74.36
1" Meter		N/A	123.93
1½" Meter		N/A	247.87
2" Meter		N/A	396.59
3" Meter		N/A	743.61
4" Meter		N/A	1,239.34
6" Meter		N/A	2,478.69

<sup>1</sup> If Company cannot obtain a signed formal agreement with AWC for commercial monthly water usage.

# **RATE DESIGN (Cont.)**

## **Service Installation Charges**

-Proposed Rates-	
Company	Staff
Cost (a)	Cost

## **Service Charges**

Establishment of Service (a)  
Re-establishment of Service  
Reconnection/Delinquent  
Minimum Deposit  
Deposit Interest  
NSF Check Charge  
Late Payment Penalty (Per Month)  
Deferred Payment  
All revenue related taxes will be charged customers

-Proposed Rates-	
Company	Staff
\$25.00	\$25.00
**	**
50.00	35.00
***	***
*	*
25.00	25.00
1.50%	1.50%
1.50%	1.50%

Main Extension and additional facilities agreements

Cost (a)	Cost
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- (a) Cost to include parts, labor, overhead, and all applicable taxes, including income tax.
- \* Per Commission Rules (R14-2-403.B)
- \*\* Months off system times the minimum (R14-2-403.D)
- \*\*\* Two Times Monthly Bill

Note No. 1: Usage rate for trailer park customers during April through September will be based on previous winter use averages (October through March). Winter rates will be based on monthly actual water usage (October through March).

Note No. 2: If a new customer is added during any of the summer months, its usage rate calculation will be based on the "park average" - defined as the average monthly usage during the winter months at that specific trailer park.

Note No. 3: For any customer being billed volumetrically, water meters that can be shown to be "irrigation only" will be excluded from the tariff calculations.